SEGALL BRYANT & HAMILL

The Acceleration of ESG in the COVID-19 Era

Corporate responsibility has grown increasingly important in recent years as companies and investors alike better appreciate the externalities stemming from the pursuit of profits. The understanding of how a company's operations impact the organization's stakeholders, now more commonly referred to as ESG (Environmental-Social-Governance) analysis, is poised to become even more critical moving forward as the COVID-19 pandemic has yielded wide-ranging political, regulatory, economic, and social effects across the globe.

Rising Prominence of ESG

Through this crisis, corporate management teams have been faced with challenging decisions as they have been forced to balance the conflicting needs of their employees, customers, suppliers, communities, and shareholders. The willingness and ability to consider ESG in their decision-making processes will potentially have lasting implications on the profitability, valuation, and public perception of their respective organizations. Companies who successfully satisfy their various internal and external constituencies can yield opportunities to extend their competitive advantages and capture market share. Those that fail to consider ESG in the COVID-era may find themselves unable to identify, address, and mitigate risks.

Likewise, investors who look beyond just short-term earnings and in turn consider corporate behavior in their stock evaluation process may also be rewarded through the crisis. While there are a multitude of approaches toward using ESG factors to influence stock selection (value-based investing, impacting-investing, exclusionary-screening, etc.), we believe a methodology which provides a framework for evaluating management's decisions is important. At SBH, we use in-depth fundamental research to better understand the ways in which leadership teams are navigating through the pandemic and positioning their businesses for the years ahead. Our research process integrates ESG analysis as part of the potential outcomes resulting from COVID and seeks to identify quality senior leadership teams with the ability to create value for all stakeholders.

Near-Term Implications

In the near term, the consequences of COVID-19 on ESG analysis are pervasive. The virus has disrupted the day-to-day lives of entire populations and in turn the operations of corporations across nearly all sectors. From a social perspective, the pandemic has put a spotlight on how companies treat their workforces. Specifically, the labor conditions, safety protocols, wage levels, and benefits arrangements provided to employees are under close scrutiny by investors. The management of employee relation dynamics is having material impacts on margins as well as repercussions on talent retention if and when demand normalizes.

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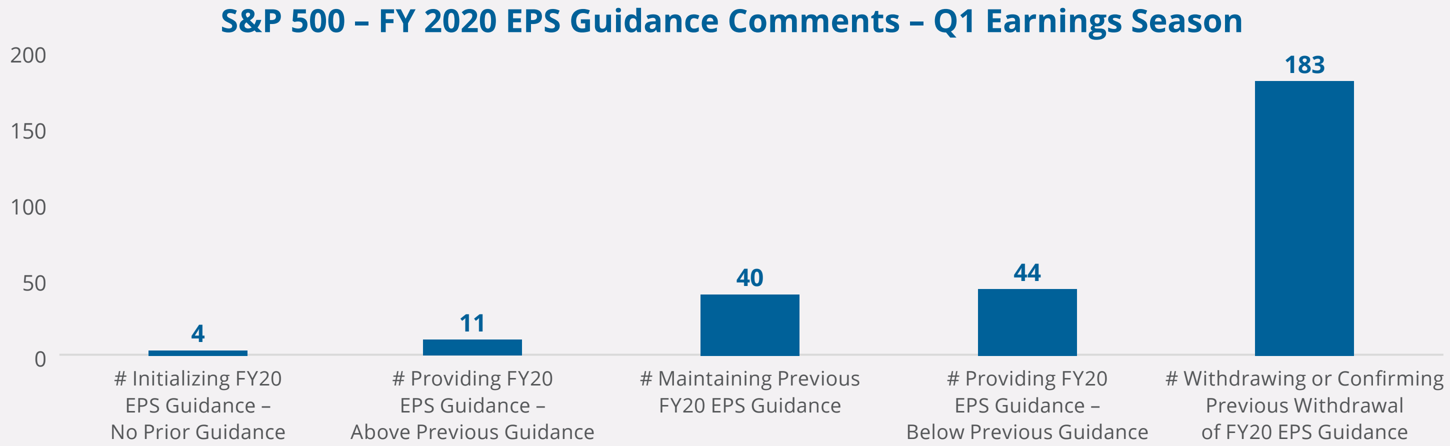
From an operational lens, COVID-19 has considerably disjointed the supply chains and routes-to-market for many companies. This has come in the form of raw material shortages, restrictions on working hours, access to personal protective equipment (PPE), and border restrictions. Organizations that proactively invested in distribution and business continuity plans pre-pandemic are using this volatile environment to displace competitors. In many instances, this strategic foresight is also translating into higher



Source: FactSet. As of 06/12/20.

valuation multiples for these well-run companies. Financially, it would be an understatement to say COVID-19 has strained balance sheets and perturbed annual budgets. This is illustrated by the overwhelming number of companies who elected to withdraw their financial forecasts for the year due to pandemic's drag on their earnings and/or destruction on their demand visibility.

That said, these unique times have also clearly illustrated how different management teams prioritize capital deployment and access to capital markets. The decisions to cut dividends, suspend share repurchases, delay capital expenditures, issue equity, pursue tactical merger and acquisitions (M&A), and/or raise capital are being closely dissected by the market as these real-times choices may have profound solvency implications down the road depending on the path of the virus in the months and years ahead.

Long-Term Implications

Longer term, the precise effects of COVID-19 are less clear as many variables remain undetermined, such as the timing of a prospective vaccine. A health crisis on the scale of this pandemic will unquestionably result in some structural changes. Politically, investors are contemplating how COVID-19 may impact globalization, country relations, future government elections, and new potential regulations. These dynamics will inform how and where companies source goods, manufacture products, and market their services. Similarly, at the consumer level, investors are trying to determine how consumption patterns may change in a post-COVID world. Depending on the path of the pandemic, it stands to reason that the virus may have lasting repercussions on where people eat, live, travel, shop, and work. Companies of all sizes will need to attentively adapt to these cultural and demographic shifts. By the same token, these societal changes will conceivably require organizations to deploy or develop novel technologies to meet the consumer in new channels. Economically, the lasting influence of COVID-19 on monetary policy, fiscal policy, unemployment, and gross domestic product (GDP) will be understood over time but will certainly have real ramifications on the cost of capital for companies.

ESG Integration

Simply put, investors are navigating through unchartered waters. However, integrating an ESG perspective into one's investment process can provide a useful compass for identifying which quality management teams will effectively lead their companies though the evolving external backdrop. COVID-19 is already producing lasting societal changes and accentuating the strengths and weaknesses many organizations had prior the virus outbreak. Those in the c-suite with the best understanding of their stakeholders' needs may be better positioned to minimize environmental, social, and governance risks (or maximize opportunities) stemming from the pandemic.

At SBH, we have consistently integrated ESG into our research processes, thoroughly analyzing both fundamental and non-financial company attributes, to better inform our holistic assessment of an investment's prospects. This approach has helped in our identification of companies that meet our quality standards and which are often the types of organizations that can sustainably outperform through market cycles. Becoming informed on how your investment manager approaches ESG can be instructive in understanding how your portfolio may potentially perform in periods of volatility.

To learn more about how SBH integrates ESG into our in-depth research process, please call us at (800) 836-4265 or visit sbhic.com